Focus	Markets	Research team
Ukraine	**Government bonds, FX market, and macro**	

Research team
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Weekly Insight

Eurobond restructuring begins

Key messages of the today's comments

Ukrainian bond market

MoF injects more life to bond market

The Ministry of Finance placed a new three-year instrument last Tuesday, which increased activity in both the primary and the secondary bond market.

Technical process of restructuring begins

Ukraine announced the full conditions for the Eurobond restructuring and invited investors to participate in the exchange offer. The exchange process will last until the end of August.

Foreign exchange market

NBU allows minor fluctuations in UAH exchange rate

The foreign currency deficit decreased last week, so the NBU allowed only small fluctuations in the hryvnia exchange rate around UAH41/US$.

Economics

NBU reserves down 1.8% in July

Gross international reserves of the NBU were down 1.8% in July and 8.1% in 7m24 on surging FX market interventions.

Annual inflation expectedly accelerates further

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THE NEXT WEEKLY IS SCHEDULED FOR SEPTEMBER 2, 2024.

MONDAY, 12 AUGUST 2024

Banks' reserves market (9 August 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.00	+0bp	-900bp
ON rate (%)	13.00	+0bp	-500bp
Reserves (UAHm)[2]	239,050	+2.7	+19.4
CDs (UAHm)[3]	529,323	+0.3	+5.0

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's certificates of deposit.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (9 August 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-2.1
Banks	720,007	-0.9	+28.9
Residents	169,634	+0.0	+40.0
Individuals	64,668	+0.8	+39.7
Foreigners	29,644	-4.9	-42.1
Total	**1,662,190**	**-0.4**	**+13.0**

Source: NBU, ICU.

FX market indicators (9 August 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.1451	-0.3	+11.5
EUR/USD	1.0917	+0.1	-0.5
DXY	103.135	-0.1	+0.6

Source: Bloomberg, ICU.

Market gov't bond quotes (12 August 2024)

Maturity	Bid (%)	Ask(%)
6 months	14.50	12.50
12 months	15.75	14.75
2 years	16.50	15.50
3 years	17.50	16.50
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

MoF injects more life to bond market

The Ministry of Finance placed a new three-year instrument last Tuesday, which increased activity in both the primary and the secondary bond market.

Last week, the MoF redeemed UAH20bn of the debut bond that the NBU allowed banks to use to cover a part of the required reserves – a so-called "reserve" bond. Therefore, banks aimed to replace this paper in their portfolios last week.

The MoF offered a new three-year paper last Tuesday instead of a 3.5-year note sold in previous weeks. Today, this bond was added by the NBU to the list of “reserve” papers. The supply cap for the three-year paper was set at UAH10bn and overall, UAH18bn of UAH bonds with different maturities were offered at the primary auction. Banks reinvested UAH10bn into new bonds, but the MoF had to raise the cut-off interest rate by 30bp to 16.5%, compared with bonds with a similar maturity sold in June. See details in the auction review.

In the secondary bond market, 10% of the trading amount was in new notes, and 35% of all deals were with "reserve" bonds. The total volume of trades doubled to UAH10.5bn.

ICU view: Last week, the interests of the Ministry of Finance and banks aligned. The Ministry needed to refinance at least part of the redemption, while banks were interested in new bonds that can be used to meet a part of the reserve requirements. Some banks also preferred to reinvest funds in older "reserve" securities in the secondary market.

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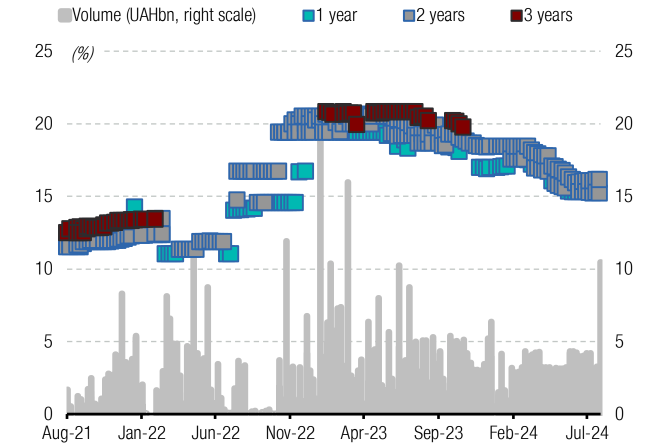
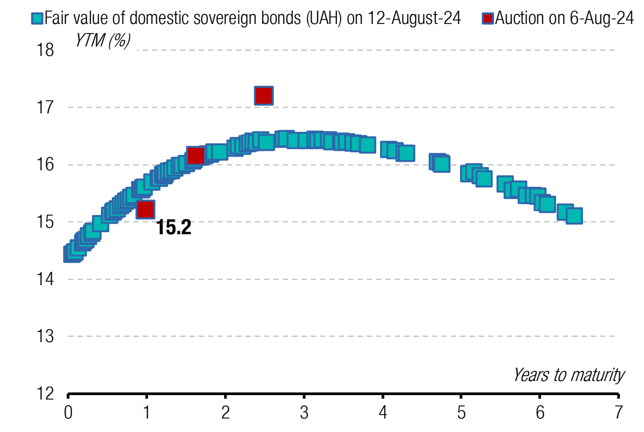
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: MFU, ICU.

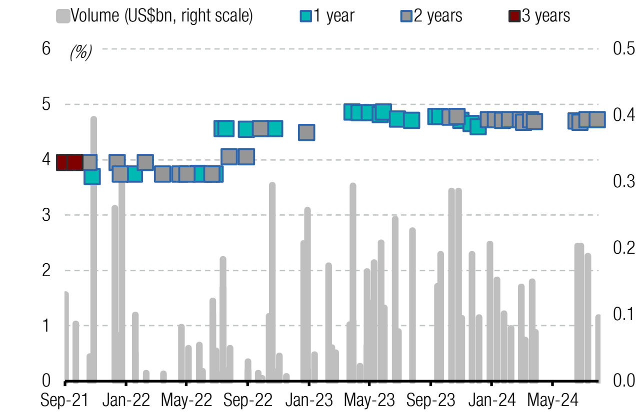
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

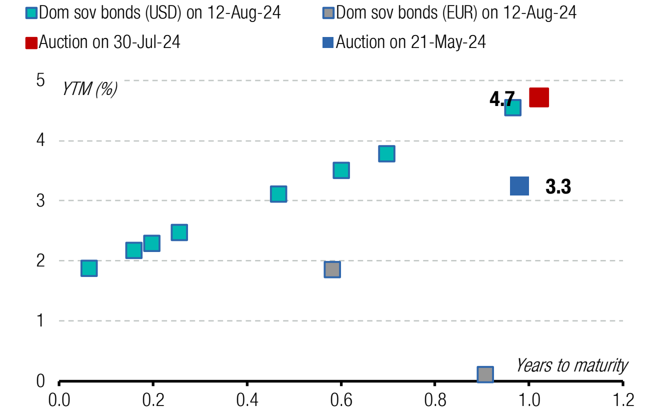
Chart 2. FX-denominated bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: MFU, ICU.

YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

Eurobond restructuring begins

Ukraine announced the full conditions for the Eurobond restructuring and invited investors to participate in the exchange offer. The exchange process will last until the end of August.

The official proposal offers an exchange of existing bonds for two series of new bonds, each consisting of four instruments with different maturities. Series A bonds are due in 2029, 2034-2036, and Series B bonds have maturities in 2030, 2034-2036. All investors that give their exchange consent will receive 40% of the current outstanding debt (principal and all accrued income from 2022) in Series A bonds and 23% in Series B bonds.

All bondholders will receive the same amount of series B bonds, while series A bonds will be distributed depending on which specific Eurobonds investors currently own. Holders of bonds due in 2024-25 will receive only Series A bonds maturing in 2029 and 2034, while holders of the longest Eurobonds will not receive Series A bonds maturing in 2029.

In addition, the nominal value of Series B bonds maturing in 2035 and 2036 may increase by the equivalent of 12% of the restructured Eurobonds if the nominal GDP for 2028 is at least 3% higher than the IMF forecast and the real GDP is at least equal to the IMF forecast (projected by the IMF in the fourth review of the EFF Programme).

To complete the restructuring, the Ministry of Finance must obtain the consent of investors who own at least two-thirds of all existing Eurobonds. In addition, for each series of existing Eurobonds, the MoF has to receive consent from at least 50% of bondholders. Eurobond holders that fail to submit their consent will not receive Series B Notes due 2035 and 2036. At the same time, holders who support the exchange until August 23 will receive a 1.25% consent fee.

Eurobond prices gradually rose since Wednesday, but after the announcement of the offer on Friday, they rose even more noticeably. Over the week, prices rose by 0.6% on average to 30.9-37.5. The price range for instruments with different maturity has expanded to 10% due to a sharp increase in the price of UKRAIN'25, which received significantly better restructuring terms than Eurobonds maturing in 2026.

The price of VRIs rose by 0.5% to 61.5 cents per dollar of notional value. The EMBI index slid by 0.1% last week.

ICU view: Given the terms of the public exchange offer, we expect a high level of participation from large institutional investors and we believe that the Ministry of

Finance will be able to complete the restructuring on time. We recommend that Eurobond holders submit their consent notifications by August 23 to receive the consent fee and obtain all the Series B bonds.

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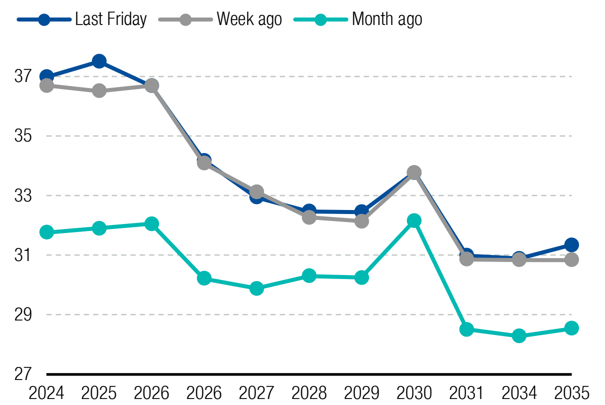
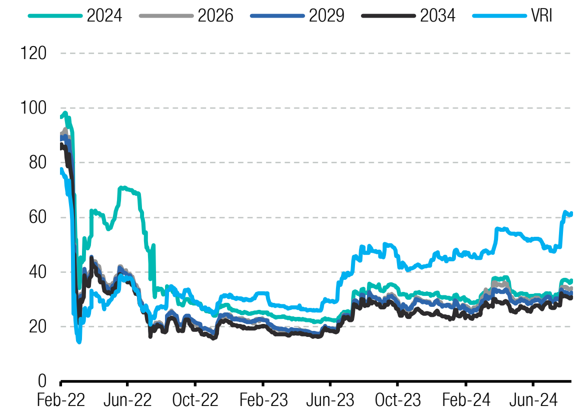
Chart 3. Ukrainian Eurobonds and VRI prices

Prices of USD-denominated Eurobonds as of last Friday, two weeks and a month ago



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

NBU allows minor fluctuations in UAH exchange rate

The foreign currency deficit decreased last week, so the NBU allowed only small fluctuations in the hryvnia exchange rate around UAH41/US$.

The hard currency deficit decreased significantly. In four business days, it amounted to US$351m, 39% less than in the same period of the previous week. The decline was due to lower net purchases of hard currency in the interbank and retail market segments. Given the better market balance, the NBU reduced interventions by 29% to US$541m.

The net purchase of foreign currency by legal entities halved to US$162m. In the retail segment of the FX market, the net purchase of hard currency was down 15% to $188m.

Over the week, the official hryvnia exchange rate strengthened by 0.3% to UAH41.1/US$, and the cash hryvnia in systemically important banks appreciated by 0.3% to UAH4.9-41.4/US$.

ICU view: After significant exchange rate volatility in July, the NBU has been satisfying excess demand for several weeks and stabilized the exchange rate near UAH41/US$. The weekly volume of interventions were below the average weekly value since the beginning of the year. The NBU will most likely keep the hryvnia exchange rate close to the current level in the short run, but will resume the controlled slow weakening of the hryvnia in a few weeks.

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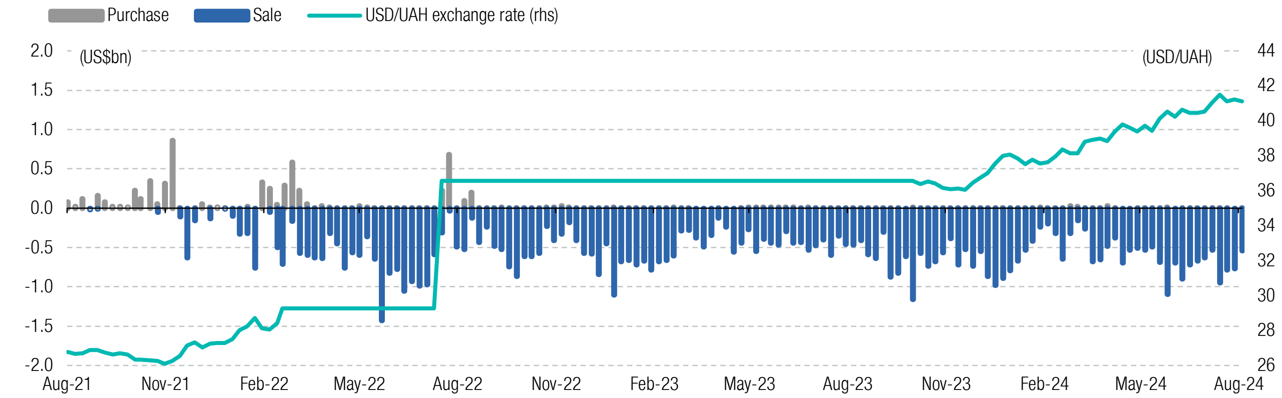
Chart 4. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market and NBU interventions (weekly data)



Source: NBU, Bloomberg, ICU.

Economics

NBU reserves down 1.8% in July

Gross international reserves of the NBU were down 1.8% in July and 8.1% in 7m24 on surging FX market interventions.

The NBU had to sell net US$3.3bn to prevent turbulence in the FX market. That was the fifth largest monthly volume of interventions since the start of russia's full-scale invasion. The inflows of foreign financial aid substantially fell short of NBU intervention needs as the government only received a US$2.2bn loan tranche from the IMF. Meanwhile, Ukraine paid US$185mn to service its foreign debt.

ICU view: NBU reserves remain under pressure due to heavy central bank interventions in the FX market. In July, the central bank was forced to step up its interventions significantly after the FX market got upset due to a rapid hryvnia depreciation. Yet, the reserves trend reversed in August thanks to a resumption of inflows of foreign financial aid. We expect end-2024 reserves will exceed the end-2023 level. The NBU will remain perfectly positioned to address all possible challenges in the FX market while continuing a managed weakening of the hryvnia.

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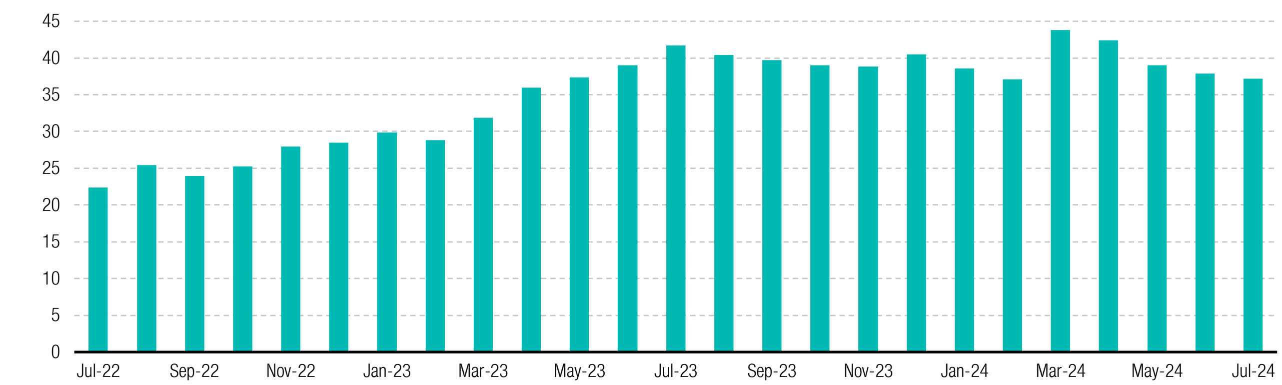
Chart 5. NBU gross international reserves, US$bn

NBU gross reserves down for four consecutive months



Source: NBU, ICU.

Annual inflation expectedly accelerates further

Consumer prices remained unchanged MoM in July, but accelerated to 5.4% in annualized terms, up from 4.8% in June.

The pickup in annual consumer inflation was primarily driven by food as their prices started to grow YoY after four months in negative territory. Due to hot weather conditions, the production of fruits and vegetables fell short of last year's numbers, and monthly food deflation was less significant than during July of last year. Other consumer basket components showed mixed dynamics in annual terms. Nearly all of them changed only marginally, except for transportations services, as their prices slowed to 10.8% YoY from 13.0% in June.

ICU view: Annual CPI accelerated expectedly, but somewhat above our estimate. Inflationary risks apparently increased somewhat recently, but they remain relatively low by historical standards. Inflation is set to accelerate further to 6-7% by September, but we believe it will remain below the current end-3Q24 NBU projection of 7.9% (this NBU projection does not account for a possible rise in VAT). We also see high chances of end-2024 inflation being below the NBU forecast. The key risks looking forward include a hike in excise tax on motor fuels (price effects likely to be offset with a decline in oil prices) and a likely increase in VAT from September. Another pro-inflationary factor is a gradual hryvnia depreciation, but it doesn't seem to have a pronounced impact on prices.

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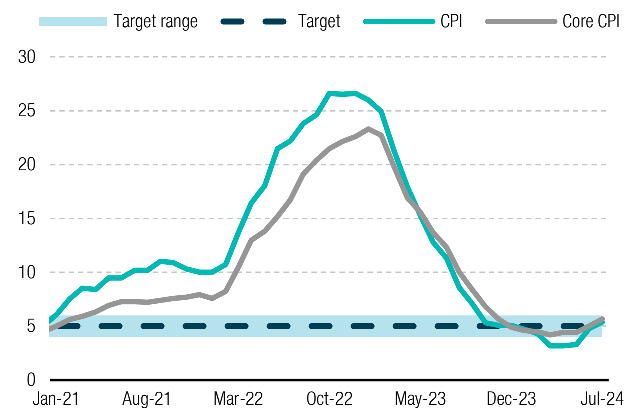
Chart 6. CPI, core CPI and target, YoY, %

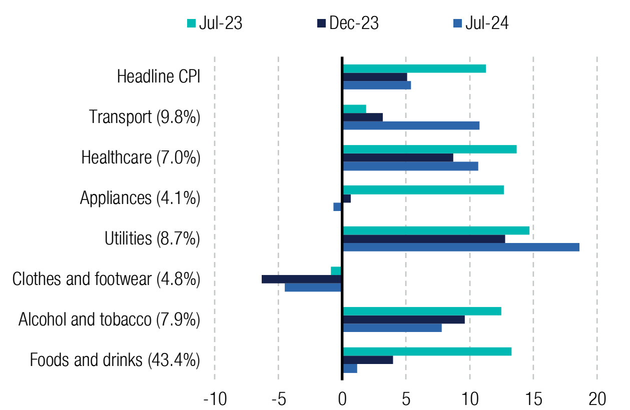
Annual inflation expectedly continues to accelerate



Source: Ukrstat, NBU, ICU.

Chart 7. CPI and its main components, YoY, %

Food prices up YoY after four months in negative territory



* numbers in brackets indicate the share of the component in consumer basket

Source: Ukrstat, ICU.

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